Citation: 2011 TCC 224
Date: 20110421
Dockets: 2008-3646(IT)G
2008-3647(GST)G

BETWEEN:

ILYAS MALIK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT
(As prepared for delivery from the Bench
on March 23, 2011 at Toronto, Ontario)

Hershfield J.

[1] The Appellant was assessed under the *Income Tax Act* (the "*ITA*") for unreported income for the years 2004 and 2005. He was also assessed under the *Excise Tax Act* (GST Portions) (the "*ETA*") in respect of the period January 1, 2002 to December 31, 2005. All such assessments are being appealed and were heard on common evidence.

[2] Regarding the reassessments under the *ITA*, the gross income reported in 2004 was $80,030. The amount reassessed under the *ITA* was $116,623 reflecting an adjustment of $36,594. The Appellant also claimed business expenses of $67,457 which were reduced by the reassessment to $37,525 reflecting an adjustment of $29,930. The expenses disallowed related to motor vehicle expenses, travel expenses, telephone and utilities and capital cost allowance. The taxpayer claimed rental expenses of $6,800 as well which were reduced to $4,000 reflecting an adjustment of $2,800.

[3] In respect of 2005, reported gross income of $71,024 was reassessed under the *ITA* and increased by $76,042 to $147,066. As well, adjustments in the same business expense categories as mentioned in respect of the 2004 taxation year were made for 2005 disallowing $35,954 of the $49,585 claimed. Adjustments were also made to rental expenses in the amount of $11,009.

[4] Assessments under the *ETA* were on the basis that the Appellant was a GST registrant and as such was required to collect and remit GST. It is not disputed that the Appellant neither collected nor remitted GST claiming his supplies were zero rated or that his taxable supplies were under $30,000. As a registrant, however, he claimed investment tax credits (ITCs) for the years 2002, 2003 and 2004. The Appellant was assessed for GST remittable on the basis of taxable supplies being the full amount of his gross income as reassessed in respect of the 2004 and 2005 taxation years. With respect to the period from January 1, 2002 to December 31, 2003 adjusted gross business income was determined to be $85,443 for the 2002 calendar year and $98,130 for the 2003 calendar year. Although there were no income tax reassessments for those two years, Respondent's witness at the hearing, the auditor on the reassessment file, gave evidence that the reported income in 2002 was $88,383 and in 2003 it was $73,260.

[5] The Appellant operated a business under the business name Ilyas Enterprises which was assumed to be, and which he testified to be, operated as a sole proprietorship. However, he also testified that he was actually a partner in a partnership formed in Pakistan which carried on business through it agents or partners abroad such as himself in Canada and the father of one of the partners in Pakistan who represented the partnership in the United States.

[6] The principals in Pakistan obtained manufactured leather goods from manufacturers in Pakistan and sought markets for such goods in Canada, United States and elsewhere. The Appellant's testimony was to the effect that his role in Canada was to seek orders from potential Canadian retailers and wholesalers. He would approach potential customers personally, some of which would be local flea market dealers and others would be just potential customers taken from lists generated in Pakistan of persons or entities in Canada who were buyers of leather goods and whose business might be sought by offering similar goods at better prices. To this end, the Appellant testified that he would take business trips to places like Ottawa and Vancouver to show samples and generate sales.

[7] At this point, I note that the Appellant also testified that only 10% or 15% of his sales were Canadian. He testified that the balance of his sales were to the United States and Japan. While it seems credible that the partnership's business might have only consisted of 10% or 15% in Canada, it is simply not credible that the Appellant personally did business anywhere other than in Canada to Canadian customers. To say that his sales were mostly in the United States undermines everything he said about the way he conducted business in Canada and the way the partnership did business in the United States through its representative there.

[8] Here I note, as well, that the assumptions in the Reply to the GST Notice of Appeal reflected what the auditor was told during initial audits namely that the Appellant's customers were located in Canada, the United States and Japan. I do not believe the Appellant's testimony supports this factual assumption. That is not to say that I find the auditor's testimony as not being believable but rather my finding speaks to the Appellant's disregard for telling things as they are.

[9] Indeed, my general impression of the Appellant's testimony is that it is for the most part unreliable. When he needed to make a particular assertion to support what he believed would be a self-serving purpose, his story would frequently change accordingly. On the other hand, where he saw no obvious self-serving purpose, much of his testimony painted a picture of his business that was quite probable, if not entirely true.

[10] For example, after acknowledging that there were several partnerships in Pakistan all tied to the same business, he was asked why so many. His answer suggested was that there was really only one partnership or one business and that the partners in Pakistan simply managed all the accounting amongst different partnerships in such a way as would enable the best banking arrangements and the best tax results. That is to say that his income allocations may well have been somewhat arbitrary or formulistic based on considerations other than sales in Canada.

[11] Indeed, his first story to the auditor was that the unaccounted for receipts that the auditor eventually included as unreported income were all money from the Pakistan business. He then said in his Notice of Appeal that such amounts were gifts from family members. Then at trial, he presented evidence that they were loans from family members in Pakistan. The evidence produced was attested to certified statements from family members in Pakistan who acknowledged giving loans in the subject years that happened to equal in total each year the amount assessed as unreported income for that year. As well, the wording of each was such

as to reflect that they were dictated to each for signature. “I paid -- (such and such) -- as borrowed -- Because he got difficult time in Canada and he is living with family”. That same quotation appears in all three exhibits.

[12] When it was suggested that the evidence that he was producing in respect of loans from family in Pakistan were prepared for the purposes of the trial and prepared much later than when the loans were actually made, the Appellant testified that there was correspondence at the time the loans were made in letters he sent that confirmed monies were being lent to him but that the family members in Pakistan would have those letters, not him. It is noteworthy that none of the certified acknowledgements referred to any such letters.

[13] When confronted with the assertions in the Notice of Appeal that they were gifts, he then said that they *were* really gifts at the beginning but that there was always an understanding that they could ask for the money back later and they did ask for the money back some years later and it was eventually repaid this last year. It is hard to guess what story he would conjure up to explain the inconsistency of his testimony as it pertained to the letters he asserted he wrote documenting that they were loans at the outset. His counsel offered the explanation that this reflected the way family support was extended in Pakistan, however, that explanation has not impressed me given my general distrust of the Appellant’s testimony.

[14] That is not to say, however, that I would not make allowances for misunderstandings when it comes to questions and answers in a litigation context, particularly in a case such as this, where the Appellant’s English was such that he often relied on the interpreter engaged by the Court for that purpose. For example, the Appellant testified that he did *all* of his business at home. That is, he took orders and filled orders by telephone and the like all out of the home office. He also testified that he would go to flea markets on weekends to deal with retailers there, as well as testifying that he would take samples on sales trips to places like Vancouver and Ottawa. I accept the likelihood that he intended all answers to accurately describe how he carried on business. He just did not relate the need to elaborate on his answers to the questions first posed. Yet, if it were not for follow-up questions as to how he carried on his business, the answers to the original questions on the home office would have left a completely wrong impression of how the Appellant carried on the business. That said, while being sensitive to such communication difficulties, I remain distrustful of much of the Appellant’s testimony.

[15] Returning for a moment to the exhibits of certified acknowledgments of loans, I note that Respondent's counsel objected to the admission of these exhibits as hearsay suggesting that there are ways to put in evidence from witnesses abroad that would permit cross-examination. While he is correct that the evidence is hearsay and could not be given any weight as to the truth of their content, I reserved my finding to admit those exhibits in order that I could assess their relevance in the context of all the evidence presented at the hearing. Considering that context, I eventually denied the objection and allowed the exhibits to be entered as tendered including an exhibit which was Mr Malik's own affidavit respecting the so-called loans. That affidavit did not correspond with his testimony at the hearing given under affirmation. At the hearing he said the loan in 2005 came from one person – a friend. The affidavit says the loans came from two relatives.

[16] Returning now to the reassessments, it is important to deal with the methodology employed by the auditor in quantifying the unreported income. The assessments were done using what was referred to as a bank deposit methodology. The Appellant maintained several bank accounts. Essentially, there were two accounts that made up almost 100% of the income reconciliation done by the auditor. There was a business account and a personal chequing account. The auditor included all deposits from both of these accounts as business income. She did this on the basis that the Appellant had told her that he did not deposit all business receipts into the business account but made such deposits in either account and further that the income from Pakistan was put into the personal account. A read-in from discoveries also confirmed an admission by the Appellant that partnership distributions from Pakistan were deposited in his accounts in Canada.

[17] Admittedly, it is difficult to defend against such methodology but the Appellant is a victim of his own wonton disregard for acceptable business and accounting practises. He said he relied on what he was told by people and on an accounting service operated by a person who was not a professional accountant.

[18] Notwithstanding language and cultural issues here, which may have influenced the Appellant's conduct in terms of how he carried on business, who he relied on for accounting and tax advice and how he dealt with the auditor and the appeal process, I am not satisfied that at the end of the day he can be given any latitude in respect of these appeals. The Canadian tax system is based on a self-reporting system. This applies to new Canadians, who venture into new business activities in Canada, as much as it applies to seasoned business persons. The lack of proper accounting records and supporting documents, in this case, has not only

made it impossible to determine with any degree of certainty the actual business income of the Appellant but it is further blurred by an organizational structure emanating in Pakistan. Such arrangements must be documented in such a way so as to identify with certainty the legal nature of the relationships of the parties as well as their income entitlements so as to permit consistent and legally effective income and expense allocations amongst the various jurisdictions in which these enterprises operate.

[19] Mr. Malik testified that his income in Pakistan was reported in Pakistan not Canada. On being confronted with inconsistencies in respect of that testimony, Mr. Malik said it was not him that would have reported any income in Pakistan. It would have been the partnership that would have reported it. Needless to say, he did not indicate which of the several partnerships, that he had testified existed, reported the income. I have the distinct impression that he would not know the answer to that nor do I trust that there was any reliable reporting done in Pakistan.

[20] In any event, as a resident of Canada he is liable to report his world wide income in Canada and the lack of records is unacceptable. It is the taxpayer's task, in order to be successful, to take me out of the cloud in which I find myself in this case. The lack of a legal format, the extent of cash dealings, and the wanton disregard for recordkeeping simply makes it nearly impossible to do more than what the auditor did, namely, look to the bank deposits. In this regard, the Appellant's counsel submitted evidence that the auditor had done a net worth assessment, as well, which established under that approach that there would be much lower unreported income than that assessed using only the bank deposit approach. Indeed, he pointed out that the net worth approach determined that there was no under-reporting of income in 2004 and only some $20,000 of unreported income in 2005. The Appellant's counsel sought justification for the methodology used when it was clear that a net worth approach would have yielded a completely different result.

[21] The auditor's answer to this was two-fold. Firstly, she said that the net worth that had been shown to the Appellant and tendered as an exhibit was only a rough draft and could simply not be relied on. Secondly, and I think more importantly, she did the assessment on a bank deposit basis because of what Mr. Malik had told her in their initial interviews. That is that the deposits came from his business arrangement in Pakistan and that money was put directly into both his business and personal accounts.

[22] As well, I note here that in yet another exhibit, tendered to explain other sources of money, there is translated correspondence relating to a sale of property

in Pakistan showing that proceeds were to be applied against a loan. On the other hand, it was pointed out on cross-examination, that Mr. Malik had purchased property in 2006 in Pakistan and the inference of that question was that he still had the proceeds from the earlier sale to apply to further real property purchases in Pakistan. Mr. Malik's response was that this was an occurrence every year that he bought and sold property in Pakistan for a profit.

[23] Needless to say, there is no explanation as to why these profits on sales of property in Pakistan on a yearly basis are not shown in the two returns submitted as exhibits at the hearing. Perhaps, if these transactions had been disclosed to the auditor, a net worth assessment might have had a different result but, regardless of that, I have little confidence that Mr. Malik has made any effort to find out what his responsibilities are in Canada as a Canadian resident in respect of his tax obligations.

[24] That takes me to comment on the expense denials in respect of the income tax assessments. In cases like this, I often consider the possibility of doing what even the Appellant's counsel in this case did not ask me to do which is to give better recognition to expenses that would obviously have to have been incurred. An example of this would be expenses in relation to the automobile. The Appellant did testify that he had two vehicles and that one was used 100% for business. However, he kept no logs or other records that would assist in the determination of the extent of business use. On the other hand, to allow no business use in the face of testimony accepted by me would be something I might attempt to avoid. It is after all credible that there was business use of his vehicle in the Toronto area such as, for example, visits on weekends to flea markets. However, he did not describe the distance travelled to any flea markets or the frequency of such visits to flea markets. He did not provide records that would indicate mileage at the beginning of the year versus mileage at the end of the year so that total distance travelled in a year might be assessed against the likely distances travelled to places like the flea markets. While such evidence is not of the type generally preferred, compared to detailed mileage logs, it is, nonetheless, possible to reconstruct with some degree of accuracy some percentage of business use for an automobile. Sometimes even an appointment book, which obviously was not maintained in this case, might be of some assistance in this regard.

[25] Still, recognizing that such expenses are inevitable in the business accepted by me as having been performed in Canada should logically allow for some recognition. Indeed, I have in the past on occasion dispensed rough justice based on simple logic and have encouraged agreements amongst the parties on that basis

as well. I maintain the correctness of that position in spite of the Crown's reliance on *Haniff v. The Queen*,[1] a February 2011 decision of Justice Boyle who cited a decision of the former Chief Justice Bowman who in essence said that it is not for a judge who is only left with a vague suspicion that assessments may be somewhat in error, to redress such error when it is clear that the taxpayer is unable to provide any degree of specificity in respect of the required treatment. While that rings entirely true in this case in respect of the income inclusions, I am not so convinced of its application in this case as to the allowance of certain expenses.

[26] However, in that regard, my hands are still essentially tied. It appears that the auditor already allowed, for example, for 10% of the automobile expenses and a good portion of the telephone expenses presumably incurred by the use of the phone in his home office. I have no basis to increase the allowable portion of these expenses or to allow other unclaimed home office expenses.

[27] The only other expense that was dealt with at the hearing was the travel expense where the Appellant testified that the travel expense of his wife and son to go to Pakistan should have been allowed as a business expense since they went there to conduct some business on his behalf when he was under some travel restrictions at the time. I do not find this testimony which is anything but disinterested very reliable. I am of the view that business in Pakistan was run by a Pakistan partnership in respect of which his wife and son, in all probability, would have little to do with. Accordingly, I make no adjustments to the assessments as they relate to allowable expense deductions except in respect of the 2005 expenses related to the rental income in that year which allowance the Respondent has conceded.

[28] As well, at the hearing, the auditor testifying for the Respondent acknowledged an overstatement of gross income of $5,000 for the 2004 year and accordingly that amount should be reduced from the assessed amount.

[29] That takes me lastly to deal with the GST assessment. As a registrant the Appellant is required to collect and remit GST on all transactions. His assertion that his transactions would be zero-rated under Part V of Schedule VI of the *ETA* as supplies for export, have not been proven. As I have indicated, I do not find it credible that his business included any foreign sales except to the extent that he was allocated a share of income from the Pakistan partnerships. However, to the extent that income is properly considered as income by virtue of it being received

[1] 2011 TCC 112.

as such from a Pakistan partnership source, it is not income in respect of which GST can be presumed to be assessed. While I could, of course, adopt the practice enunciated in *Haniff* namely where there is no specificity, then there is no tax break, I cannot in good conscious do that in this case. The auditor herself formulated her assessment methodology on the basis that the unreported income was coming from Pakistan. It was the theory of the Canada Revenue Agency's approach. It is wholly inconsistent with that theory to assess GST on such gross income as if it reflected sales in Canada. Further, it cannot be a coincidence that I have formed the exact same view of this case. Acknowledging that there is inevitably some degree of arbitrariness in accepting *reported* gross sales as Canadian business and accepting *unreported receipts*, as evidenced simply by bank deposits, as not reflecting taxable supplies, I am still satisfied that the evidence viewed in the light of the assessing theory, demands my accepting such approach to the quantification of the Appellant's liability under the *ETA* for the subject period. There is no pretence here, in any event, that the assessments are accurate – they ignore the cash transactions that never reached the bank accounts that the Appellant admitted to – they do not account for real estate sales in Pakistan and they may, in fact, have included some as business receipts but, at the end of the day, except as allowed here, the Appellant has not satisfied the burden placed on him to prove that the assessments are wrong.

[30] As to the ITC denials under the assessments under the *ETA*, no evidence was tendered as to any entitlement to the credits claimed by the Appellant. It is unlikely that he paid GST in respect of any of his purchases.

[31] One last comment on the reporting obligations and the bank deposit methodology used in this case lest the Appellant has not learned something in the course of these assessments and the prosecution of his appeals. Two things should be obvious from this Judgment. One is that both the Appellant's domestic and foreign business arrangements need to be organized and structured, in a legal manner, with appropriate documentation in place to support the filing position arising from that legal structure. Secondly, a bookkeeper or accountant is going to sooner or later have to show the Appellant that business bank accounts need be segregated to account for all business transactions and that each and every bank entry requires a support ledger that indicates the nature of the entry and the background to it. Behind that ledger are the physical documents that support or evidence the explanation of the entry. Without the latter supporting documentation, ledgers will become questionable and will lose their value in supporting a particular treatment in respect of bank statement entries.

[32] Finally then to summarize my findings, the 2004 appeal of the reassessment under the *ITA* is allowed by reducing the reassessed business income by $5,000 from $116,623 to $111,623. The 2005 appeal of the reassessment under the *ITA* is allowed by increasing the allowable expense in respect of the rental property by $11,009. The appeal in respect of the assessment under *ETA* is allowed by reducing the taxable supplies as follows: for the 2003 calendar year to $73,260; for the 2004 calendar year to $80,030; and for 2005 calendar year to $71,024

[33] Costs are awarded to the Respondent on the basis of a single Class A appeal.

Signed with minor edits at Winnipeg, Manitoba this 21st day of April 2011.

"J.E. Hershfield"

Hershfield J.

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